No. 101

IN THE

Supreme Court of the United States

OCTOBER TERM, 1947

MARRINER S. ECCLES, RONALD RANSOM, M. S. SZYMCZAK, JOHN K. McKEE, ERNEST G. DRAPER and RUDOLPH M. EVANS, PETITIONERS,

v.

PEOPLES BANK OF LAKEWOOD VILLAGE, CALIFORNIA

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REPLY BRIEF FOR THE PETITIONERS

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It is not the purpose of this brief to reply seriatim to each of the arguments advanced in respondent's brief. There are, however, a number of those arguments which appear to inject considerations not presented by the opinion below and which have not been discussed in our main brief. These are largely confined to Points I and II of respondent's brief and we shall confine our reply to those subjects.

We wish first to address ourselves to a basic but false assumption which permeates a large portion of respondent's

brief and upon which many of its subsidiary arguments are premised. It is that respondent was unable to *control* the disposition of its stock by its stockholders and, hence, was unable to prevent Transamerica from acquiring any of its shares, even if respondent had wished to do so (R. Br. pp. 7-9, 14, 21, 22, 55). From this assumption respondent makes a number of arguments, including the principal one that the Condition is thereby rendered arbitrary and unreasonable and is therefore void.

We think that it is a complete answer to this and all related contentions to point out that respondent, through the stockholders which controlled it at the time of its admission to the System (who gave assurances to the Board that they did "not intend to enter into any" agreements to sell their stock to Transamerica), with perfect validity could have regulated the transfer of its stock to the extent necessary to protect respondent against future violations of the Condition by the simple expedient of adopting a by-law limiting such disposition to meet the requirements of the Condition. In Fletcher, *Cyclopedia Corporations* (Perm. Ed., 1931, Vol. 8, Section 4205, pp. 784-787) it is stated that by-laws designed to protect the corporation and its interests by partially restricting the transfer of the corporation's stock "as by limiting the persons to whom it might be transferred" may be validly enacted by a corporation. Fletcher further points out that "the weight of authority seems to be that such restrictive by-laws are proper and not necessarily objectionable per se, but are consistent with common sense and practical business, especially in the case of corporations of special nature or purposes or those in which the stock carries some special stockholder's liability." Id. Furthermore, the laws of California under which respondent was organized and operates specifically empower a corporation to enact by-laws restricting the transfer of its shares. Section 303

of Chapter IV of the California Civil Code, which enumerates that which may be regulated by corporate by-laws, states, *inter alia*, as follows:

> "The by-laws of a corporation may make provisions not in conflict with law or its articles for:
>
> • • • • • • •
>
> "7. Special qualifications of persons who may be shareholders and reasonable restrictions upon the right to transfer or hypothecate shares."

Another assumption that appears in numerous contexts in respondent's brief is that certain allegations contained in their complaint must be taken as admitted because not denied by the answer (R. Br. 6, 11, 14, 15, 20, 69). The first one of these is the allegation that at the time respondent applied for System membership it was "in all respects qualified and eligible for membership" (R. 3). Another is the allegation that Condition No. 4 "is arbitrary, unreasonable, capricious, discriminatory," etc. (R. 5) Such allegations, we submit, are but the mere conclusions of the pleader and, therefore, have not been admitted. See *Isbrandtsen & Moller Co.* v. *United States*, 300 U. S. 139, 145; *Nortz* v. *United States*, 294 U. S. 317, 324-5; *Pennie* v. *Reis*, 132 U. S. 464, 470; *Rosenhan* v. *United States*, 131 F. 2d 932, 934 (C. C. A. 10), certiorari denied 318 U. S. 790; *Fletcher* v. *Jones*, 105 F. 2d 58, 60 (App. D. C.); *Lucking* v. *Delano*, 122 F. 2d 21, 27 (App. D. C.); *Putnam* v. *Ickes*, 78 F. 2d 223, 226 (App. D. C.) certiorari denied 296 U. S. 612; *Magee* v. *Hermann*, 17 App. D. C. 52, 56, affirmed, 183 U. S. 572; *United States National Bank of La Grande* v. *Pole*, 2 F. Supp. 153, 158 (D. C. Oregon).

Under Point I respondent argues (R. Br. 26) that for the Court to uphold the validity of Condition No. 4 would be

to extend the limits of the Board's authority to impose conditions of membership relating to management to unreasonable or even absurd proportions. They argue that the Board should be restricted to considering only the *existing* "management" of an applying bank and should not have the power to consider the character or identity of its stockholders.

The answer to this contention is that the Board, having been charged with the duty of appraising each situation as it is presented, must necessarily have discretion to impose such conditions as appear necessary to meet each such situation. It follows that the validity of the conditions in each case must be determined in the light of the particular situation to which they are addressed.

Respondent contends that petitioners' argument that Condition No. 4 was related to the soundness of the Bank's management is insincere because when the majority below ruled that the Board might properly invoke the Condition *after* a showing that the Bank's management, policies or personnel had been deleteriously affected by the Transamerica acquisition, petitioners thereupon argued in this Court that the decision below emasculated the Condition and stripped it of its vitality (R. Br. 26-27).

The answer to this argument is that the Condition shows on its face that the Board had determined that the Transamerica management was unsound *at the time of the Bank's admission.* Hence, the Board was protecting the Bank and the System against the possibility of Transamerica's entry into the Bank's management at any time while that situation prevailed. To require that the Board await damaging results to the institution before it might properly invoke the Condition would, therefore, deprive the

Condition of its effectiveness as a preventive or prophylactic measure.

Respondent also attacks the validity of petitioners' argument that the Condition is related to the "convenience and needs of the community to be served by the Bank" (R. Br. 27). It challenges this argument on the ground, first, that as a part of its original application the Bank enclosed a copy of a communication from the Superintendent of Banks of the State of California which contained his finding that "the public convenience and advantage will be promoted by the establishment of a new bank in this location". The fact is, however, that the Commissioner's finding was coupled with the requirement that the new bank, before it might commence operations, should first obtain Federal deposit insurance (R. 35-36). His decision, therefore, was tantamount to saying that only if Federal insurance was granted (upon the terms set forth in the Federal Reserve Act, which requires the Board to consider "the convenience and needs of the community to be served by the Bank"), would the Bank be permitted to operate in the State.

Secondly, it is charged that petitioners' argument is an afterthought because no reference was made to "the convenience and needs of the community" in the Board's letter of March 11, 1942, which stated the circumstances under which the Board would agree to reconsider the Bank's application. While it is true that the precise words Convenience and Needs of the Community" were not used, nevertheless Paragraph No. 5 of that letter expressly required a showing that "the bank was organized as a bona fide local independent institution" (R. 54). And the same statement

in substance appears in the Board's letter of May 6, 1942 (R. 60).

Respondent argues that the fact that the Board required the Bank formally to evidence its acceptance of the conditions of membership outlined in the Board's letter of May 6, 1942, "is cogent evidence that the Board did not believe that it could impose the Condition, relying solely on its own power, and make it effective" (R. Br. 44). This argument is utterly baseless, since the Board always requires applicants to accept any conditions it imposes. Here, as in any case where the Board admits a bank to membership, the requirement is intended merely to insure that all persons in authority in the Bank are fully aware of the conditions that have been imposed and are not permitting the Bank to enter System membership unaware of the responsibilities and requirements of that status.

Next, respondent argues that Condition No. 4 is contrary to the purpose stated in Section 12B(y) of the Act, which relates exclusively to the deposit insurance provisions of the law and provides in part as follows:

> "It is not the purpose of this section to discriminate, in any manner, against State non-member, and in favor of national or member banks; but the purpose is to provide all banks with the same opportunity to obtain and enjoy the benefits of this section."

Upon the basis of this quotation respondent makes the novel argument that, as no power is conferred upon the Deposit Insurance Corporation to annex conditions in granting insurance, respondent is being discriminated against in being made subject to Condition No. 4 by the Board (R. Br. 45-46). The answer to this contention is twofold.

In the first place, respondent did not apply to the Deposit Insurance Corporation for insurance; it applied to the Board for admission to the Federal Reserve System and the Board has specific statutory power to impose conditions on member banks. In the second place, respondent's contention, if upheld, would have the effect of amending Section 9, by construction, so as to prevent the Board from imposing conditions of membership upon any applicant which is not an insured bank—a limitation which finds no support whatever in the plain wording of the statute.

Next, respondent urges that the Condition is inconsistent with various statutory provisions which show that bank holding companies have been recognized by Congress as legitimate forms of business enterprise and that there is no statutory prohibition against such companies owning stocks in member banks (R. Br. 46-48).

The answer here is that, in passing upon the "character of management" of an applying bank, the Board legitimately is concerned with eliminating all, whether holding company or individual, who might offer potential danger either to the bank itself or to the System. In this case the Board had determined that Transamerica was pursuing unsound policies and that these policies offered potential danger to both respondent and the Federal Reserve System. We may take it that if, at the time a bank seeks membership in the System, the Board ascertains that a particular *individual* is associated or about to become associated with the management of such institution and the Board had concluded that the presence of such an *individual* in the management of that bank represented a potential dangerous influence, the Board would be empowered to condition the bank's membership upon the re-

moval of that *individual* and upon his thereafter remaining outside the bank's management. We see no valid reason for distinguishing between corporations and individuals in this regard, particularly since the bank holding company is the more likely to undertake to supply the *entire* management of a particular bank and not merely a part of it as would be the case with an individual. Under respondent's argument the Board would be required to permit any holding company, no matter how unsound its policies, to participate in the management of a member bank upon the wholly untenable premise that Congress has not prohibited holding companies generally from owning stocks in member banks.

Next, respondent argues that Condition No. 4 "runs squarely counter to the provisions of Section 9(12) of the Act (12 U. S. C. § 330) which guarantees to State member banks the retention of their 'full charter and statutory rights.'" (R. Br. 48).

The complete answer to this argument is contained in the words of the statute immediately preceding those quoted by respondent. They read: "*Subject to the provisions of this Act and to the regulations of the board made pursuant thereto,* any bank becoming a member of the Federal Reserve System shall retain its full charter and statutory rights". (Italics ours) Obviously, a condition of membership imposed pursuant to the power conferred upon the Board by Section 9 of the Act is a "provision of this Act" or a "regulation" of the Board which might properly limit the full exercise of a member bank's charter powers. Indeed, the examples of membership conditions cited in our main brief (P. Br. 14-15) show a number of clear instances of the application of this principle.

Respondent also argues that Condition No. 4 is inconsistent with the provisions of Section 9(9) of the Act which allow a bank to withdraw voluntarily from System membership (R. Br. 50). Respondent argues that Condition No. 4 makes the "voluntary" right to withdraw a "compulsory" duty to withdraw. But no better example of a "voluntary" undertaking could be found, we submit, than that evidenced by respondent's action and that of all of its stockholders and directors in their representations made to the Board in 1942 for the purpose of securing respondent's admission to the System.

Respondent further argues that the Condition is inconsistent with certain other provisions of the Act which provide for the removal of officers and directors of member banks found guilty of "unsound and unsafe practices" or for the termination of Federal deposit insurance for the same reason (R. Br. 50-52). In considering this argument it should be borne in mind that the sections referred to in respondent's brief comprise but two of the alternative methods provided by statute for dealing with this general subject. There are at least two others—the power of the Board to expel a bank from membership (Section 9(8) of the Act), and its power to impose conditions of membership (Section 9(1) of the Act). The choice of alternatives is obviously a matter for the bank supervisory authorities to consider in the light of the circumstances of each particular case. It would seem clearly preferable, however, to adopt that alternative which would remove a potential cause of unsafe or unsound practices, especially where, as here, such potential cause can be foreseen.

Respondent's constitutional argument, which is contained in Point II of its brief (R. Br. 57-58), hardly merits reply.

It seems to be that, because Congress could not itself condition the admission of a member bank against the subsequent ownership of any of its shares by a *particular* company such as Transamerica, it may not lawfully delegate this authority to the Board.

It is sufficient in answer to this contention to point out that what Congress has done under Section 9 is merely to delegate to the Board the authority to make detailed determinations in applying a legislative policy to particular facts and circumstances—that is, to apply a general standard to a particular company. Here the Board had determined that if a *particular* holding company should acquire respondent's stock, an unsound situation might result which would be detrimental to the banking system which Congress had created. Clearly Congress had the authority to protect the System against such a result and one of the methods which it adopted as a means to that end was the entirely reasonable one of authorizing the Board to impose conditions of membership. As the Court said in *Yakus* v. *United States*, 321 U. S. 414, 424:

> "The Constitution as a continuously operated character of Government does not demand the impossible or the impracticable. It does not require that Congress find for itself every fact upon which it desires to base legislative action or that it make for itself detailed determinations which it has declared to be prerequisite to the application of the legislative policy to particular facts and circumstances impossible for Congress itself properly to investigate. The essentials of the legislative function are the determination of the legislative policy and its formulation and promulgation as a defined and binding rule of conduct . . . . It is no objection that the determination of facts and the inferences to be drawn from them in the light of the statutory standards and declaration of policy call

for the exercise of judgment, and for the formulation of subsidiary administrative policy within the prescribed statutory framework."

Respectfully submitted,

PHILLIP B. PERLMAN,
Solicitor General.

ROBERT L. STERN,
Special Assistant to the Attorney General.

GEORGE B. VEST,
General Counsel,
J. LEONARD TOWNSEND,
Assistant General Counsel,
Federal Reserve Board.

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